



Business and Economy Review

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SUMMARY

On the final lap of election competition the authorities of the Republic of Moldova tended to use both administrative and indicative tools in their economic policy. The Ministry of Finance received indications from the President regarding the social priorities to be supported financially. Simultaneously with the decrease of interest rate on its instruments the National Bank of Moldova also advised other banks to lower their interest rates on deposits. The Government intends to impose additional regulations in order to control imports, hoping in this way to reduce the commercial deficit.

Many commercial banks reacted on the monetary changes and recommendations of the NBM, having provided for respective asset and liability policies. Interest rates began to fall in February, simultaneously with the reduction of interest rates on state securities. The presence of the National Bank on the foreign exchange market was insignificant; it obviously decided to save resources for the forthcoming interventions in 2005.

The real growth of GDP amounted to 7.3%, biggest growth being registered in the service sector and in construction. However, GDP amounted to 105.8% of final consumption, while capital investments reached the level of 18.6% of GDP that is fairly insufficient for assuring a sustainable economic growth and a positive impact on the life standards. The cause of these unfavorable trends is the too slow progress in the improvement of national business environment in 2004; in some cases even regress was registered. In January got materialized the first results of investment deficit – reduction of growth rates in industry down to 7.7% from 8.9% in 2003.

As for the business environment, after the entrance into force of the „guillotine law” the Government doesn't yet intend to launch a more complex and radical reform. The Government appeared prepared to present to the Parliament proposals on amendments to the law on free economic zones in order to allow the agents registered in these zones to sell a part of their products on the rest of national territory. This intention would disappoint the public opinion and provoke negative reactions from international financial institutions as it contradicts the principles of fair competition and ruins the idea the free economic zones were created for – stimulation of foreign trade.

The average price growth rate in January was 1.1%, being in compliance with the previous forecasts of EXPERT-GRUP. This growth was conditioned by the increase of prices for foodstuffs, this tendency being preserved in February as well. During the following months the dynamics of inflation to a considerable extent will be determined by the structural policies of the new government.

Nominal annualized increase of salaries in January was 20% and the deficit of labor force on the national market is the main factor of this increase. This deficit is especially acute in construction and in agriculture. Unemployment attained 8.2%, the highest level during the last four years. However, it would have been much higher without emigration. The major cause of such high unemployment associated with the intense emigration of the labor force is caused by the slow rate of formation of new businesses.

Global market changes have not been favorable for Moldova as the prices for hydrocarbons (imported to Moldova) rose considerably while the prices for cereals (exported from Moldova) fell down, thus worsening the country's terms of trade. The Moldova's position is not likely to change also in the first half of the year 2005. However, positive economic growth is expected in the countries representing main export markets for Moldavian products. Most of the incertitude is associated with the economic policy of the new Ukrainian government that will have to revise the illegal privatization transactions being careful in order not to worsen the external perceptions of the country's business environment.

On the international arena Moldova received some aggressive notes from Russia; however, the implementation of threats before elections is of small probability. Simultaneously relations with Russia may worsen even more depending on the extent to which Russia will intrude into the post-election events in Moldova. Several interesting ideas were heard on joining the efforts of Moldova and Ukraine in the field of European integration.

Internally, the post-election crisis became more probable, for the moment it is unclear how will the policy be contoured after 6th March. Anyway, one can not hope too much for a completely new-formatted government as the Parliament and the Government will include many already well-known figures. A real change will occur during the next elections that may take place even before the year 2009. Bad relations with Transnistria are even more compromising as the votes given or unused by the Transnistrian electors can be very important for the post-election period.

MACROECONOMIC POLICIES

Administrative reflexes

Tax and budget policy

The year 2005 began with a quite powerful fiscal relax. The state budget managed to collect 55% greater income compared with January 2004. During the recent years has become remarkable the growth of fiscal incomes, now this indicator is estimated at 88% for January 2005. Increase of the portion of this type of income compared to 66,1% in 2001 attests an improvement of the Government's fiscal policy achieved by widening of the fiscal basis. Simultaneously, the Government must consider fiscal policies allowing to consolidate the incomes from direct taxes in the long run in order to reduce the dependency on VAT and excises with negative social impact.

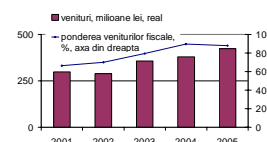
Simultaneously, negative trends were also observed in the economic policy. In January the fiscal-budgeting policy and the policy of its promoter - Ministry of Finance, *volens-nolens* also were involved in the elections campaign. Participating in the session of the Council of the Ministry of Finance, the president of the Republic of Moldova „has pointed at the priority directions of activities of the Ministry of Finance for the next four years” (cited from the official message from Presidential press-service). „During the forthcoming period all the plans of the Ministry of Finance, calculations and measures associated with their implementation shall be oriented towards the achievement of most important social objectives”, affirmed the President.

Two comments can be made. First, the country's President should not intrude with indications and „pointing” in the activity of ministries, as according to the Constitution of the Republic of Moldova he is the chief of state but not of the Government, while the Government's activity program is approved by Parliament and not by the President. Second, probably by occasion, the tasks recommended to the Ministry, coincided with the election promises made by the Communist Party of the Republic of Moldova in the current election campaign¹ and had nothing in common with the priorities set out in the Economic Growth and Poverty Reduction Strategy or with the mid-term Cost Breakdown. This example of political inconsistency is not unique in the national economic policy and such practices must be definitely eradicated as they compromise the executive independence of the organs responsible for the „implementation of socially important objectives” and objectives determined by much more democratic methods compared to the indications of the president².

Monetary and exchange policy

NBM began this year with a significant reduction of interest rates on many instruments of monetary policy. On 18th February 2005 was approved the Decision of NBM's Administration Council by which the interest rate on the long-term credits offered by NBM was lowered from 11,5 down to 11%, i.e. to the level of the year 2003 when the annual inflation rate was 15,8%. This change consolidates the long-term trend pursued by NBM in order to reduce the interests. Also in February the rate on „overnight” deposits was lowered down to the historical minimum of 2%, while the interest rate for „overnight” credits was reduced from 17% down to 15%. The rate for mortgage facility was lowered from

2005 began with major fiscal note...

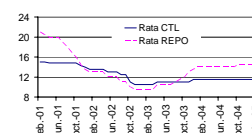


surse: DSS

... but the political factor got abusively involved in the determination of fiscal priorities...

...requiring the fiscal policy to align with the electoral program of the governing party

NBM reduced the interest rate on long-term credits and REPO...



Surse: NBM

¹ The Ministry of Finance must keep in mind that for the society of Moldova it is important to create around 300 new job places and to at least triple the average monthly salary in order for it to exceed 300 US dollars, triple the pensions, to double the number of places financed by the state in the institutions of higher education, triple the student allowances and double the guaranteed package of medical services rendered to the citizens of the country

² On 2nd February the President of the Republic of Moldova organized several more sittings attended by the association of banks, representatives of the National Commission on Securities and of the National Bank of Moldova. During these sittings the President Voronin spoke about „some suspicious transactions” on the capital market during December 2004 – January 2005. Ten days later the National Commission on Securities again prohibited the transactions on the off-board market, and on 18th February the Parliament dismissed two members of the NCS from their positions. The problem itself is not contained in the fact that the transactions are illegal or not, or that the members of NCS are guilty in any infringements or not (such facts in a democratic society being determined by a court and not by the president) but in the context and manner in which the political factor intrudes into the activity of market regulation institutions.

16% down to 14%. However, these reductions are of small importance, the most significant factor being the reduction of the basic rate for REPO operations from 14,5% to 13%.

Also, NBM approved the amendments to the Regulation on the classification of credits and formation of credit risk funds. The officials of NBM have declared that the approval of these amendments will allow the banks to make crediting more accessible, as credits amounting to less than 30.000 thousand lei would be available without mortgage or other guarantees. One can question the accessibility of credits for the producers, even the small ones, interested in receiving greater amounts. Simultaneously consumption credits are strongly promoted and this can result in the growth of prices.

... and reduced the rigors of credit policy...

For the first instance, NBM „recommended” to the commercial banks to revise their interest policies for liabilities. Even after the officials of NBM negated any administrative underlying reasons, one can easily notice that this recommendation can not be interpreted otherwise but as a camouflaged warning. The context in which this recommendation was made is not favorable for the image of NBM and one can suspect the NBM of loss of independence in the election period. Or, by the end of October 2004 the prime-minister Tarlev „advanced” for the reduction of interest rates on credits issued in national currency down to 15% per annum. However, this desire is difficult to implement in an economy characterized by an inflation of 12%.

The extent to which the relax of credit policy is aimed towards the priority objectives of the economic policy is disputable and will be determined after several years of credit expansion. It is too early to forecast how many of the credits issued in 2003-2004 will be reimbursed and what are the risks associated with long-term credits. Obviously, reduction of interest rates is necessary. However, the continuous relax of monetary policies must be compulsorily accompanied by promotion of structural reforms: privatization of production sector and privatization of Banca de Economii, improvement of corporate management and adequate supervision of commercial banks and private companies. NBM can not assure a stable macroeconomic environment as long as the structural policies are anemic.

Exposing the country to a higher risk of inflation...

EXPERT-GRUP considers that the policy of cheap money is in contradiction with the principles of inflation subdue. Generally, for some time the NBM doesn't let the public understand what is the main scope of its monetary policy. Jugglery of priorities by NBM can be rational in the short-run only, while in the long-run it deteriorates the public trust to the monetary policies.

... risking to loose the public trust to the objectives of its monetary policy

FINANCIAL CLIMATE

Reduced interest rates

In January the interest rates on deposits and credits increased by respectively 0,23 and 0,05 percent. It is expected that in February the NBM will announce smaller average rates in its statistics. Several important commercial banks already reacted to the substantial reductions of interest rates operated by the NBM (see **MONETARY POLICIES**) and one may expect this tendency to spread over the entire banking system. The recommendation of the NBM to the commercial banks to reduce their interest rates on attracted resources was perceived as a very strong signal.

The banks reacted to the signal of NBM by reduction of interest rates and extension of credits

Simultaneously, the NBM surely understands that a durable reduction of interest rates is realistic only in a non-inflationist environment. In January the inflation registered a historical minimum for the period (see **PRICES**), however there is an uncertainty regarding the implementation of inflation objective of 8-10% by the NBM in 2005. After the elections the new government will be required to initiate painful but necessary social reforms accompanied by increase of prices and tariffs. Not compulsorily being of inflationist nature, these single time measures will increase the Consumer Price Index.

We consider that a significant reduction of interest rates, besides the use of credit policy instruments by NBM, implies another type of structural policy in the banking sector. This sector is lacking competition with external operators of banking services, the rates offered by the national commercial banks being high, inclusively due to the quasi-oligopolist structure of the market. If a highly operative international bank is admitted to the market of Moldova, being in right to render the entire range of banking services, the interest rates would fall down naturally and very reliably as the local banks would have to align their management and marketing to completely different standards. For the moment it seems that the commercial banks are victims of politicians that can not tolerate the situation in which one sector flourishes while the other ones are in stagnation and will have to give up the high margins they used to collect.

However, a durable reduction of interest rates can not be implemented without major structural reforms in the economy

Interest rates on state securities decreased drastically, the nominal rate registered a powerful reduction of 1,25 points in January and presumably around 3,5 points in February, having reached the record minimum of 3,6%. The driving factor of this dynamics was again the demand that several times exceeded the supply of the Ministry of Finance and that is determined by the desire of the banks to place their resources in liquidity assets. This trend denotes that the banks are afraid of the persistence of certain risks associated with the crediting of investment projects with higher rates of return compared to state securities. Inevitably, reduction of interest rates for state securities will generate similar incentives for the reduction of banking interest rates and the banks will have to review their crediting policies.

... and due to this reason the banks still tend to procure non-profitable and low risk state securities

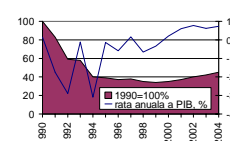
In February the Government approved the new edition of the draft law on leasing. If it is adequately adopted and implemented, the new law will simplify the legislative hindrances and the procedures of leasing operations and will extend the range of qualifying persons and the range of goods considered as objects of leasing. This law will also eliminate the fiscal disadvantages currently faced by the participants of this sector. These changes will have positive implications for the generation of new schemes for crediting businesses.

REAL SECTOR

Lacking investments...

By the end of January the Department for Statistics and Sociology of the Republic of Moldova published the preliminary estimates of GDP growth for the year 2005. According to the calculations of DSS, the GDP rate was 7,3% that is 0,3 p.p. more than maximum value of the growth interval previously forecasted by EXPERT-GRUP. In the variation of GDP, 6,6 p.p. are constituted by the real growth of gross value added and 0,7 p.p. – by net taxes and import-export duties. The breakdowns by sectors have not been made available to the public, and our estimates of growth structure and sector contributions remain the same as in January: agriculture rose moderately by 2%, industry – by 9,3%, construction – by 20%, services – by 8,7%³. Based on the results for the year 2004, Moldova is currently at the level of 45% of the GDP for 1990.

GDP grew by 7,3% in 2004...



Source: DSS

GDP was used for 105,8% for the purposes of final consumption, out of them 89,3% were used for household consumption and 14,9% for the consumption of public administration. Around 22,3% of GDP were invested, inclusively 18,6% were invested into the gross capital formation and 3,7% - into stock variation. Increase of investments into fixed capital is too slow to assure a sustainable economic advance. The rate of investments into fixed capital has not yet attained the level of 1998 when a rate of 22% was registered. The cause of these unfavorable trends is the very slow progress in the improvement of business environment on national level, in some areas even regress was registered (see **BUSINESS ENVIRONMENT** and no. 1 in „ABE”).

The crucial importance of investments was demonstrated in the service sector that made the maximum contribution to GDP. Th sector of mobile telephony was the most dynamic sub-sector. Pursuant to the information published in February,

³ See **REAL SECTOR IN** in „ABE” no. 1, January 2005.

in the year 2004 the income of GSM mobile telephony operators amounted to 894 million lei, having risen by 64,3 % compared to the year 2003. According to the ANARTI, in the year 2004 the investments made by the two companies doubled compared to the year 2003. To mobile telephonic networks are connected more than 317 thousand subscribers, the density of mobile telephony per 100 inhabitants attained 21,81%.

.. but investments again grew below expectations...

Net exports represented -31,1% of GDP. Net exports evolved remarkably - in the manner similar to the one of the year 1999: exports expressed in lei rose in real terms while the imports decreased, leading to a reduction in the negative value of net exports.

According to the preliminary statistics, in January industrial production amounted to 7,7%, being smaller than 8,9% registered in 2004 and 13% in 2003. We believe that in the following months industrial output will not recover from the decline to the intensive growth of 2003 and first half of 2004. Another alarming factor is the fact that in January retail product sales rose only by 6,1%, while the value of services rendered to the population rose by 6,8.

... and one is not amazed by industrial braking

EXTERNAL COMMERCE

Commercial deficit – a new headache

In January-February the Government appeared to be especially preoccupied by the growth of the balance of trade, having decided to intensify the control of imports. In January an action plan was approved in order to improve the situation in the field of external commerce and to reduce the negative balance of trade. The Department of Commerce was appointed responsible for the elaboration of „concrete measures”. However, this solution proved to be a double rebuff. First, the respective structure is already well-known to us owing to its author's title on a „juridical masterpiece” of 2004 - the Common Regulation on functioning of markets. Second, it is ridiculous to see how the entire commercial policy of a country is being determined at the level of a department that by its own definition doesn't dispose neither of the necessary human resources, nor of institutional capacities required for the formulation of any proposals to the commercial policy.

Reduction of trade deficit is a new priority of economic policy...

In February a subject of hot debates has become the concrete proposal of the Department of Commerce on the measures necessary for the reduction of negative balance of trade. Among the ordinary measures borrowed from previously approved documents there were proposed several unusual measures aimed to inhibit the imports and eliminate the intermediaries from the commercial chain. The document proposed by the Department casts light over the serious problems existing in the field of economic analysis. The existence of intermediaries is a logical consequence of high transaction costs in the economy and their elimination in the short run would result in the increase of these costs and in the long-run it would result in the appearance of new intermediaries. Also one must mention that the initial objective – reduction of trade deficit could be compromised by the expansionist monetary policy of NBM (see **MACROECONOMIC POLICIES**), as the cheaper credits will stimulate consumption of imported products as well.

... but a wrong responsible authority was chosen for the elaboration of policy

The problem of trade deficit can not be resolved by the limitation of imports as they grow in line with the necessities of a growing economy, while the households are eager to consume after many long years of poverty. It is practically impossible to substitute imported TV sets, refrigerators and autonomous heating installations with the ones produced locally due to the fact that they are either not produced in Moldova, or are not competitive. The problem of trade deficit must be resolved from the perspective export expansion and for this the government must remove the internal barriers, both formal and informal. If the government were not to approve the well-known administrative restrictions against the export of cereals, the trade deficit would have been lower by several dozens million dollars.

Reduction of negative balance of trade requires elimination of administrative barriers for exports

BUSINESS ENVIRONMENT

Rushing between different interests

The month of January again showed us that liberalization of telecommunication services produces substantial positive impacts on the market. The competition is intensified under the influence of new competitors entering the market. Despite of the fact that compared to Moldtelecom the new market participants are of smaller sizes, they have made the dominating company to establish a clear development strategy. Positive changes also include the initiative of introducing the principle of one-stop-window in order to simplify the external commerce, as well as the elaboration of a new draft law on leasing.

The government intends to simplify the bureaucracy of external commerce ...

On 6th February was enacted the Law on optimization of normative framework for the regulation of business activity (see analysis no. 1 of „ABE”, Chapter **BUSINESS ENVIRONMENT**). This action is very important but not sufficient for the consolidation of production potential of the private sector. The government should launch a complex regulatory and integration reform. For the moment the Government still hesitates to initiate a radical and systematic revision of institutional components of its own administrative-regulation framework. Other recent actions of economic policy suggest that the Government doesn't understand that a regulatory reform can not be based on the principles of exceptions, political departures and preferential agreements. Recently was approved the national investment attraction program for the year 2005 named „ProInvest” that provides the determination of priority sectors for the attraction of foreign and local investments by the Government, selection of potential investors according to some criteria and issuance of special certificates for the assurance of a „green corridor” for the implementation of investment projects.

... and to determine priority sectors for which green corridors are to be provided to investors...

Obviously liberal, this initiative contradicts to the fundamental principle of public policy according to which the reform must create equal possibilities for all investors, irrespectively of their sector of activity. The Government should not in any way get involved in the selection of priority sectors or in the issuance of any “green corridor” certificates for the qualifying investors only. Such a treatment is counter-productive and will stimulate corruption, traffic of influence and bureaucracy for the eradication of which the reform itself was launched. Implicitly this initiative questions the efficiency of other components of this reform, such as continuous simplification of registration and licensing procedures. Besides these, agriculture and agricultural services, the sectors that assure the existence of the biggest portion of the country's population and where investments and business activity require urgent intensification are not even mentioned among the priority sectors for the Government.

... that can generate corruption and even greater inequality

EXPERT-GRUP considers as a wrong move the approval of the Regulation on the preparation for the conversion of corporate entity debts to the state budget into shares. The correctness of this decision is disputable as it compromises the bankruptcy procedure. The „Black List” can be continued with the initiative of offering the right to sell a part of alcohol products on the country's territory to the free economic zones. This solution contradicts with the principle of equitable competition as the economic entities from free economic zones operate in more advantageous conditions compared with the ones on the rest of the territory when the free economic zones themselves have been designed for the stimulation of exports from the Republic of Moldova.

PRICES

Reaching a seasonal minimum

According to the data published by the Department for Statistics and Sociology of the Republic of Moldova, the monthly inflation rate for the month of January amounted to 1,1%, as previously forecasted by EXPERT-GRUP. Re-calculating the inflation rate as set out in the Box 1, one may notice the amplification of negative social impact as the biggest increase of prices was registered in the category of foodstuffs (1,1%) while they occupy the biggest portion in the consumption budgets of the poor households. Inclusively, especially noticeable

In January inflation attained the seasonal minimum

was the rise of prices for many products forming the basis of consumption baskets of the poor households – vegetables (17,3%) and potatoes (4,5%). Cheapening of flour made the necessary premises for further reductions in the prices for bread in March.

Prices for non-foodstuffs grew insignificantly (by 0,4%), while the prices for garments and footwear grew by 1,8% (primary necessity goods) and thus did not affect the budgets of disfavored households as they usually do not buy them in the winter time. The tariffs for basic services (communal, telecommunications, transport) did not increase as such changes can occur only by virtue of administrative decisions expected to appear not earlier than in the months May-June when the elections are over and the new government is established. Even if substantiated economically, increases of tariffs for transportation and communal services involve too high political risks.

... but in February prices grew by around 0,8%

According to our estimates, in February the prices grew by 0,8%, the most considerable growth being registered in foodstuffs. We expect that in March the prices will grow by 0,7%.

Box 1. How relevant is the inflation rate calculated by the DSS?

Generally speaking, the Consumer Price Index is calculated by the ratio of a representative consumer basket value that includes food, domestic use goods and services registered for the current period to the price registered in the base period. Variations of CPI are determined based on the individual variations in the prices for different goods and services multiplied by their shares in the structure of household consumption budgets. In order to perform an inter-temporal comparison the shares of such goods in the consumption budget must be constant. However, for the sake of relevance it is important for the IPC to reflect better the real consumption structure of a typical household. Thus, one should periodically review the methodology of calculations (once per 3-5 years).

EXPERT-GRUP was unable to clarify with the officials of the Department for Statistics and Sociology when was the share of foodstuffs, other goods and services comprised in the CPI last reviewed. We are convinced that the shares presently used by the DSS do not reflect the real consumption structure of the households (see Table 1).

Tabelul 1. Re-calculation of CPI

	Share in CPI used by DSS (2)	Share in the household consumption budget, total households (3)	Share in the household consumption budget, poor households (4)	Growth of prices			
				2001	2002	2003	2004
Foodstuffs	4659	5840	7580	6,1	2,8	20	13,3
Manufactured goods	2957	1710	920	7,9	8,2	11,5	12
Services	2384	2450	1500	4,5	4,4	12,6	12,6
CPI according to the methodology of DSS (shares in column 2)				6,3	4,8	15,8	12,7
CPI according to the household budget structure (shares in column 3)				6,0	4,1	16,8	12,9
CPI according to the budget structure of poor households (shares in column 4)				6,0	3,5	18,2	13,1

Sources: DSS, UMSP and EG calculations.

As one can observe from the Table 1, this methodology leads to systematic underestimation of inflation when the prices for foodstuffs grow higher and to underestimation of inflation when the prices for foodstuffs grow less rapidly. This effect is especially noticeable in the case of households defined as poor that have to support relatively higher costs due to the increase of prices for foodstuffs⁴.

⁴ The Poverty and Policy Monitoring Unit under the Ministry of Economy has established for the year 2002 an absolute poverty threshold at the level of 270,7 lei per person.

LABOR AND HOUSEHOLDS

Census without surprises

By the end of January were published the first results of population census performed in October 2004. These results are very important for the analysis of labor market and structure of consumption demand. The census determined that Moldova is the most rural country in Europe (Transnistria excluded) - (61% of population lives in villages). More than 65% of total urban population live in the two big cities – Chisinau and Balti. Such a demographic structure has serious economic implications:

- The population, being very dense and very rural for the regional standards, prefers emigration as basic survival strategy in an economic environment that doesn't offer many chances of alternative employment;
- Balti and Chisinau absorb the labor resources to a substantial degree, providing the people with resources for survival but simultaneously postponing the time horizon when the investments will be made into smaller urban localities and into the rural ones;
- The consumption structure is unbalanced, especially in the villages, the share of final costs for foodstuffs being very high and the share of costs for the procurement of consumer durable goods being very low.

Also, the census made an estimation of the number of people working abroad, it being at around 367 thousand persons, or 11% of population. Even if the mass-media stated that the real number of people employed abroad is much higher, i.e. around 1 million persons, the number determined by the census is within the limits of reasonable estimates made previously by independent experts. Simultaneously, according to the other investigations, the emigration potential is much more significant⁵. The Exodus of the labor force provokes a deficit in the labor force in many very important sectors of economy (construction, agriculture, etc.) and induces an intensive growth of minimum wages acceptable for the people employed nationally. In January the salaries grew bigger by 20% in nominal terms or by 7% in real terms.

In January were also published the statistical data on the economically active population and unemployment for the quarter IV, 2004. The Department for Statistics and Sociology determined for the first time that 13% of the total number of people employed are working in the unofficial sector and that more than 1/3 of people have at least one working place in the unofficial sector. These estimations are commensurable with the data made available by the independent researchers. Simultaneously, the rate of unemployment registered in the last quarter (8%), even if it is smaller than in T'4-2004, the unemployment for the year 2004 still remains at the level of 8,2%, 0,2 points higher than in 2003.

The researches demonstrate that persistence of high unemployment simultaneously in intensive emigration of able-bodied citizens is first of all associated with the low rate of creation of new companies⁶. The promises made by the candidates during the elections to triple the number of working places and salaries from this perspective appear to be lacking any argumentation as none of the parties managed to demonstrate the source of creating so many working places and how will be assured the correlation between the salary rates and labor productivity. Improvements registered in the business environment in the year 2004 are not sufficient for the unshackling of the creative private sector potential, especially in the situation when in January-February were registered several cases of departure from the liberal political tone (see **BUSINESS ENVIRONMENT**).

The census showed that the labor market is dominated by rural inhabitants

... and that 367 thousand people emigrated abroad.

High inflation is aggravated by relatively high unemployment

⁵ See Edgardo Ruggiero, „Migration and Remittances – A Micro Perspective”, in IMF „Republic of Moldova: Selected Issues”, January 21, 2005.

⁶ Jan Rutkowski, “Firms, Jobs and Employment in Moldova”, World Bank Policy Research Working Paper 3253, March 2004.

COMMERCIAL PARTNERS

Optimistic perspectives for Moldova as well

Oil. In the second half of the year 2004 the prices for oil remained high, despite of the fact that in real terms they are lower than during the oil crisis of 1970ths. After a short pause in November-December 2004 they grew again higher in January. We expect the oil to remain expensive during the first half of the year as the global market is characterized by high volatility.

Prices for oil and cereal will correlate unfavorably for Moldova...

Cereals. Good harvests in Europe and in the countries of the former USSR will raise the production of cereals by 10%. The price for cereals will decrease, thus allowing to recover the stocks. Main importers of cereals will be the countries of Asia, especially China.

To our expectations, the global economy in the year 2005 will register a growth of 4%. The main risks able to compromise this growth are the geopolitical uncertainty, high and unstable prices for oil, aggravation of „germ deficits” in USA and the risk of drastic growth decrease of the Chinese economy. We expect that in the first trimester of the year 2005 in the USA will be registered an annual growth of 3,5%, similar with the rate registered in the last trimester of 2004, it probably being the result for the year 2005. In the Euroland the growth remained anemic. However, some encouraging syndromes also were noticed. Statistical data for January 2005 already display positive evolution. The producer's confidence index improved, especially in the service sector. The confidence of European consumers is stable during the last four consecutive months. Nevertheless, it would be better for their appetite to grow but unemployment and some pessimist perspectives can act as limitation factors.

USA will follow a good growth trend while EU is again behind

Economic growth in the EU may face several important risks. The budget policies are a special problem. After the main economies of Europe have again registered big deficits, EU will have to find compromise solutions in order not to hinder the economic recovery of old members and not admit discrimination of the new ones. Secondly, labor market policies must be continued, as the unemployment installed at terrifying levels can compromise the consumer confidence and the consumption expenditures. Third, the EU will have to be more flexible in decision-making. There still are important differences between the EURO zone members and universal solution may not always be optimum ones. In this way, a restrictive monetary policy can be suitable for such expanding countries as Spain and Ireland, but for sure too rigid for the senescent Germany.

The GDPs of new EU members and accession candidates are ascending, growth being supported by exports and private consumption. Simultaneously, the growth of these countries will remain dependent on the speed of final consumption demand in the EU and evolutions on the oil market. In the year 2004 the growth of prices for oil resulted in a greater inflation and in the worsening of current accounts. The economic growth in the region for the year 2005 can be estimated at around 4,5%.

The new member countries wish to be convergent with the EU and UE attain higher growth

In Romania the internal demand and inflation were determined by rapid growth of salaries and banking credits. The new Government will have to make substantial efforts in order to control private credit and salaries in the public sector. In the year 2005 the main growth contributors will be the processing sector, the service sector and the retail commerce. Serious problems include business environment, quality of governance and corporate management. Despite of these, we expect powerful growth in 2005 as well.

In the year 2004 the main commercial partners in CIS (Russia, Ukraine, Belarus) registered good economic growth determined by high prices for oil and external demand for the basic raw materials. Simultaneously improved the private domestic consumption. These changes create the necessary premises for the continuation of reforms and restructuring that will be the last stage of deeper economic recovery and reduce the dependence of these evolving economies on the markets of natural resources.

Growth in the CSI was unexpectedly high, thus forming the basis for the continuation of structural reforms

In Ukraine the fresh government of Timoshenko will have to face an already known range of problems: reforms of public administration, fiscal reforms and reforms in the housing sector. If we add to these the modernization of social assistance system, fiscal consolidation, better assurance of contractual and property rights, review of several important privatization transactions, one can see how complicated will be the mission of the new government. For the moment the perspectives are enough optimistic and we believe that economic growth in Ukraine in the year 2005 will attain 8%.

... the Ukraine's tasks being most challenging among all other countries of CIS

INTERNATIONAL RELATIONS

Bad play of Moscow

Our previous forecasts on the involvement of Russia into the election process and threats of economic sanctions got materialized in February. However, the gross manner in which the threats were launched has exceeded all expectations. On 18th February the State Duma of Russian Federation has adopted a declaration by which the government of Moldova is warned about the fact that in the case it continues the „blockade of Transnistria and destabilization of the region”, the Russian Federation would introduce a number of economic sanctions against Moldova, among them being the supply of energetic resources on the entire territory of Moldova (except Transnistria) at global market prices, blockade of imports from Moldova and introduction of visa regime. Obviously, the cause of these affirmations was not Transnistria itself but the expulsion of Russian political communication and election technology specialists without excessive ceremonies.

Russia openly threatened Moldova with sanctions in order to influence the electoral behavior

The probability that in the nearest future before elections Russia would implement these threats, is very low due to the following factors:

- Risk of further worsening of its image on the international level;
- Sanctions will have a negative impact on the ethnic Russians living on the right bank of Dniester;
- Enormous economic losses that can be suffered by Russian Trading Houses that are engaged in the imports of alcohol products and tobacco from Moldova;
- Technical and bureaucratic difficulties of implementing the sanctions in such a short time remaining till the election race of 6th March;
- A country willing to adhere to the WTO (an enormous deal for Russia) can not apply discriminatory commercial policies, especially towards a country that already is a WTO member.

However, one can not exclude the possibility for Russia to intervene in the elections through Transnistria by bringing to ballot-boxes more electors than Moldova is ready to accept. In this context the declaration of the President of Romania regarding the impossibility of threatening the authorities of the Republic of Moldova made by him during his visit to Chisinau gains a completely new sense and importance from the points of view of both political and energetic safety. Traian Basescu assured the authorities of Moldova that in case of need Romania will deliver electric power and provide all the necessary assistance to Moldova in order for it to overcome any obstacles on the way to European family, including the solution of Transnistrian dispute.

And its direct involvement in the elections through Transnistria is not excluded

EXPERT-GRUP considers that on the background of open threatening from Russia the collision between Moldova and Russia in the solution of Transnistrian conflict will progressively aggravate the situation even during the days of elections and in the nearest time afterwards, depending on the results of elections. EXPERT-GRUP considers that the Russian Federation can considerably destabilize the situation in the region by using its levers on influence on Tiraspol in order to tension the situation in the security zone, as this process already began in December 2004 in the form of several provocation actions in the security zone: displacement of military forces, ammunition and armored vehicles.

However, aggravation is possible even in the days of elections and afterwards

Meanwhile was effected the first demarcation of interests in the direction of joining the efforts of Moldova and Ukraine on the way to European integration. Ukraine has made very clear declarations in which it stated that by virtue of its interests of national security and European integration it can not tolerate any more the existence of any conflicts at its western border.

POLITICAL COMPETITION

Accumulation of explosive tensions

By the end of February 2005 EXPERT-GRUP considers that the probability of post-election political instability is much higher than forecasted in January. There are many overlapping factors for that. Most parties of opposition left or right orientation compared to the actual government almost daily registered breaches of Election Code by the government. The western partners in a rigid diplomatic language warned the PCRM about the progress of election campaign and the possible consequences. Understanding the risks, PCRM began to implement an active strategy compared to the positions of opponents and civil society concerned by the exercise of election process to the date. Expulsion of several Russian citizens under the accusation of illegal involvement into the election campaign was a tactically well-thought step depriving the opposition from any possibility to use the argument of excessive pro-Russian orientation of a PCRM in the post-election scenarios. However, the tactics of burnt bridges is strategically wrong as after elections it will not be easy to recover good relations with Moscow, this being an objective of vital necessity.

By the end of February the society accumulated a negative potential that will seek neutralization during the post-election period. Meanwhile, difficult relations among the different opposition parties did not allow to establish a common platform for a post-electoral action regardless of any previously conducted negotiations on this theme. It makes us believe that even in the case any opposition party tries to implement a post-election scenario of street democracy the absence of mutual understanding will not allow a coagulation of a powerful group with a leader able to accept such high political risks. The possible post-electoral political instability will hardly turn into a movement controlled by opposition, a movement with clear scopes and able to preserve its protestant energy for a long time. In such conditions the spontaneous street protests will interfere into the malicious and massive manipulation of public opinion. Even if the right opposition parties designate a common leader (this may be a person previously not involved in politics or not a first-row person), the left extremity together with PCRM would annihilate the protests by organizing counter-manifestations in the streets.

The most possible result of such movements will be the situation in which PCRM will be forced to compose a government in which important positions will be offered to the representatives of opposition parties while the country's president will be a person without a pronounced political affiliation. In such a situation a relatively soon governmental crisis is possible that can result in premature elections even in the year 2005. All these will be very harmful for business as political instability is not a favorable factor for investment activities.

During the last two months the electoral screw got compressed and the energy must be released somewhere...

... inclusively in street manifestations

... followed by installation of an unstable government, unfavorable for business

TRANSNISTRIA

Exploring new scenarios...

Apogee of crisis

Despite of the criticism towards the Moldavian officials expressed by several diplomatic missions accredited in the Republic of Moldova in the summer of last year regarding the suspension of pentilateral negotiation format, the position of Chisinau seems to be for the first time decisive and adequate on the background of aggression towards the schools of Transnistria⁷ in which Latin graphics is used. To the opinion of EXPERT-GRUP „the school crisis” has nothing in common with the linguistic factor. The reasons invoked by the regime of Transnistria for the approval of the respective decision by the so called „Supreme Soviet of Transnistria” dated 28th January 2004 providing that beginning with the academic year 2004-2005 there should not be any general education schools in the region not subordinated to the „transnistrian law”. The causes of this conflict may be found in the refusal to sign the „Kozak’s Memorandum” and in the pro-western position of Chisinau officially contoured after the rejection of memorandum. All these concerned the Russian Federation that has interests and influence levers in this zone.

Refusal of the Republic of Moldova to sign the Kozak’s Memorandum triggered the hysteria of political leaders from Tiraspol...

Impact of suspension of the pentilateral format

As response to the actions of transnistrian administration to liquidate the schools, the Government suspended the negotiations till the registration, re-opening and assurance of normal functioning of schools with teaching based on Latin graphics according to the study programs and manuals approved by the Ministry of Education of the Republic of Moldova. Such a position of Chisinau resulted in the obvious disapproval of subjects participating in the negotiations in the pentilateral format. They formulated several proposals on recovering this format. In this context most relevant were the consultations in Varna between 7 and 10 November 2004 when attempts were made in order to recover the dialogue.

And allowed to refuse from the inefficient pentilateral format of negotiations

This situation is unique for the almost 14 years of independence from the points of view of both internal and external policy. Being pressed by numerous circumstances, such as the stress exerted by Russian Federation towards the signing of Kozak’s Memorandum on one side and negative attitude of western diplomatic missions to this memorandum on the other side the Government was imposed to insist for the first time on the promotion of an internal policy expressing an independent character and pursuing the national interest. However, having rejected the pentilateral format the Government inevitably got into a difficult situation. Ukraine and Romania, being preoccupied by elections abstained for a certain period of time from any actions that could change the accents on the Transnistrian problem.

„The Orange Revolution” and the solution of transnistrian conflict

According to the Decision of Government no. 876 dated 30th July 2004, beginning with 1 August 2004 the import-export operation in/from the Republic of Moldova are performed by the legal entities located on the entire territory of the country within the state borders in strict observation of national legislation and international normative acts to which the Republic of Moldova is party. Pursuant to clause 2 of the above decision, the action of all normative acts contradicting to the set out provisions is cancelled.

Bringing back the economic agents of Transnistria into the legal space of Moldova is one of the government’s main objectives...

This step of national authorities makes illegal any import-export operations performed without the documents stated in the established prescriptions and in

⁷ Study programs and manuals approved by the Ministry of Education of the Republic of Moldova are used in the secondary school no.20 of Tiraspol, no.19 of Bender. No 12 of Rîbnița, no.1 of Grigoriopol, Moldavian school of Dubăsari, gymnasiums of villages Roghi and Corjova.

contradiction with the norms determined by the customs authorities. The adoption of Decision no. 876 was qualified by the administration of Tiraspol as a true economic blockade. This subject was widely used for the continuous tensioning of the situation by the means of transnistrian propaganda. On the first phase the attempts to bring the economic agents from the eastern regions into the legal field of the Republic of Moldova failed due to the position of Ukrainian authorities that allowed the passage of goods through their territory without the necessary documentation stating that these goods cross the territory of Ukraine in the regime of transit. The behavior of Ukrainian customs authorities can be explained by the unofficial support of the Tiraspol regime practiced by the persons at governance in Ukraine by that time.

These events occurred on the background of political instability in Ukraine, evolution of electoral campaign in three rounds and victory of the opposition candidate Victor Iushchenko. EXPERT-GRUP considers that the results of elections in Ukraine are a major factor that will influence the economic development of eastern districts. The new Minister of External Affairs recently declared that the Kiev "is for the active involvement of EU into the solution of transnistrian dispute and now everybody has to think about democratization, demilitarization and security of Transnistria". We believe that in this situation the position of Ukraine is decisively favorable for the integration of economic agents from the eastern districts of the republic in the constitutional space.

... and Ukraine's cooperation is strongly required to do this

The Minister of External Affairs of Ukraine Boris Tarasiuc qualified the solution of transnistrian problem as "one of the most important tasks for the national security of Ukrainian state". In the light of this declaration EXPERT-GRUP concludes that for the first time appeared the real premises for discussing a common Moldavian-Ukrainian monitoring of the borders on Transnistrian sector for many times invoked by Chisinau in the past. This would allow to stop any import-export or transit operations not complying with the norms of Moldavian law.

If Ukraine observes the legal regime established by the Government of the Republic of Moldova for the economic agents operating within the state borders, the performance of monitoring on the Moldavian-Ukrainian may cease to be a strict necessity. In February the Ukraine began to block the deliveries to Transnistria. The efficiency of economic instruments in relations with Transnistria is demonstrated also by the fact that in the first half of the year the regional GDP grew by 23% while the cumulative indicator for the nine months was only 9% and a negative indicator is expected for the entire year. However, on the background of political communication no measures have been undertaken to temper the spirits of some portion of transnistrian population that believes Chisinau only is guilty in the reduction of life level in the region.

... that began to materialize in February

Meanwhile in Kiev took place the discussions on the double control of commercial flux of metallurgic products. In such situation the economic agents from the left bank of Dniester already begin thinking of possible operation in conformity with the legislation of the Republic of Moldova or performance of activities in the geographic limits of the unrecognized „rmn”.

Privatization in Transnistria

In the year 2004 the Parliament of the Republic of Moldova adopted the law on privatization of enterprises from the left bank of Dniester and in Bender. Beyond political considerations the law was aimed at bringing down the dissatisfaction of certain social groups in the region by the regime of Tiraspol and to motivate international investors not to participate in privatization against the laws of the Republic of Moldova. The law provides for the free transfer of the shares of enterprises to the members of their working personnel.

Meanwhile in Transnistria appear the first courageous economic agents willing to get legally registered in Moldova ...

In February the transnistrian monolith displayed the first cracks, after the working staffs of the concern AOZT „Tirotext” from Tiraspol and ZAO „Moldavcabeli” from Bender filed applications to the Department of Privatization of the Republic of Moldova in order to have these enterprises privatized in conformity with the law approved by the Parliament of the Republic of Moldova. Simultaneously many other enterprises of Transnistria wish to bring their regulations in compliance and get registered according to the requirements imposed by Chisinau.

However, another phenomenon also got materialized, again confirming the presumption that Russia has always backed up most of privatization deals there. One must consider the declaration made by a subsidiary of RAO „EĖS ROSSII” in which was expressed the intention to purchase from „Saint Gidon Invest” the controlling stock of the Moldavian Regional Thermal-Electrical Power Station.

***... and appear the first
proofs of Russian
presence in the previous
privatization transactions***

STATISTICAL ANNEX

	1997	1998	1999	2000	2001	2002	2003	2004
Real Sector								
GDP, million MOL, current prices	8917	9122	12322	16020	19052	22566	27297	31992
GDP/capita, USD	528	465	321	354	408	459	543	767
GDP increase rate, %	1,7	-6,5	-3,4	2,1	6,1	7,8	6,3	7,3
GDP deflator,	112,6	109,4	139,8	127,3	112,1	109,8	113,8	109,2
Agriculture share in the gross added value, %	30,2	30,4	27,8	29,0	25,4	24,0	22,5	21,0
Industry and constructions share in the gross added value, %	29,0	23,5	22,8	21,7	24,7	23,2	24,7	22,5
Services share in the gross added value, %	40,8	46,1	49,4	49,3	49,9	52,8	52,8	56,5
Gross investments in the fixed capital, % in GDP	19,9	22,1	18,4	15,4	16,7	16,3	17,1	18,6
Households								
Personal monthly disposable income, MOL	133	118	133	186	241	322	422	520
Retail trade, real increase, %	-3,8	-12,3	-27,4	4,0	14,8	34,2	18,2	11,0
Services rendered to the population, real increase, %	10,2	-11,7	-10,2	0,1	21,2	11,8	12,5	4,8
Prices								
Consumer prices index	112,0	108,0	139,0	131,0	110,0	105,2	111,6	112,6
Producer prices index	120,0	109,7	144,0	128,5	112,3	104,7	108,9	105,6
Agricultural prices index	99,0	91,0	65,0	126,0	99,5	100,2	120,3	103,0
Labor								
Population, million	3,65	3,66	3,65	3,64	3,64	3,63	3,62	3,38*
Number of employees in the economy, million	1,65	1,64	1,50	1,52	1,50	1,51	1,36	1,31
Unemployment rate, OIM methodology	-	9,2	11,1	8,5	7,3	6,8	7,9	8,2
Nominal average wage, MOL	220	250	305	408	544	691	892	1117
Real average wage increase, %	4,9	5,5	-12,5	2,2	21,6	20,9	15,5	8,8
Foreign trade								
Goods export, USD million	874,1	632,1	462,3	471,5	570,2	710,6	790,3	986,3
Goods import, USD million	1171,2	1023,7	573,1	777,4	897,2	1103,1	1402,7	1774,2
Deficit of goods commercial balance, % GDP	-15,4	-23,1	-9,5	-23,8	-22,1	-23,6	-30,5	-30,4
Direct foreign investments, USD million	78,3	74,4	38,8	127,5	148,5	110,4	58,0	60,0
Transfers from gastarbeiters, USD million (official data)	93,3	99,7	90,1	126,2	183,7	239,1	258	450
Public finances								
Consolidated budget incomes, million MOL	2941,7	2721,9	3100,3	4102,4	4324,8	5084,4	6620,5	7532,5
Consolidated budget expenses, million MOL	3608,4	3027,1	3495,3	4268,8	4325,8	5194,1	6183,4	7354,5
Budgetary balance, % in GDP	-7,5	-3,3	-3,2	-1,0	0,0	-0,5	1,6	0,6
Internal public debt, % in GDP	11,0	17,2	15,5	12,6	12,6	12,5	10,7	11,8
External and state guaranteed public debt, % in GDP		49,1	65,9	79,3	64,5	59,4	51,5	26,0
Monetary indices								
Monetary basis, annual increase, %	32,6	-5,5	41,3	29,8	27,9	31,1	17,0	39,7
Official currency reserves, USD million	360	141,5	180,5	222,5	228,5	269,6	302,3	470,2
Official exchange rate, annual average MOL/USD	4,62	5,37	10,52	12,43	12,87	13,57	13,92	12,33
Interest rate credits in MOL, %, annual average	32,8	30,1	35,5	33,3	28,5	23,1	19,2	20,9
Interest rate deposits in MOL, %, annual average	24,5	21,0	27,4	24,6	20,6	14,4	12,6	15,5
Credit in the economy, stock, million MOL	1506	1771,4	1608,8	2291,2	3101,3	4165,7	5999,7	7399,3
Global economy								
GDP growth globally, %	4,2	2,8	3,7	4,7	2,4	3,0	3,9	4,5

Sources: DSS, NBM, IMF, estimates (shadowed) by EXPERT-GRUP

About us

EXPERT-GRUP is an independent thin tank, legally registered as nongovernmental organization. **EXPERT-GRUP** specializes in economic research, evaluation of public policy, political analysis and consultancy and training services. Our mission is to provide pertinent analysis and expertise that would help our partners take right decisions in an ever-changing environment. While pursuing its institutional mission, **EXPERT-GRUP** generates positive externalities that contribute to general development of Republic of Moldova and enhance its international competitiveness on multiple areas.

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